CONSTRUCTION
SONOMA STATE UNIVERSITY
UNIVERSITY CENTER

Audit Report 14-12
February 13, 2015

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ABBREVIATIONS

BOT Board of Trustees
CM Construction Manager
CM at Risk Construction Manager at Risk
CPDC Capital Planning, Design and Construction
CRB Certification Review Board
CSU California State University
EO Executive Order
GMP Guaranteed Maximum Price
ICSUAM Integrated California State University Administrative Manual
LEED Leadership in Energy and Environmental Design
OAAS Office of Audit and Advisory Services
EXECUTIVE SUMMARY

At its January 2014 meeting, the Board of Trustees directed the Office of Audit and Advisory Services (OAAS) to review construction activity. Construction auditing had been performed by KPMG since fiscal year 1997/98 with coordination from the OAAS. In fiscal year 2008/09, OAAS staff began performing construction audits.

We visited the Sonoma State University campus and the offices of the construction manager and selected subcontractors from September 15, 2014, through October 24, 2014, and audited the University Center project focusing on the construction management policies and procedures and internal controls and processes in effect at that time.

In our opinion, the fiscal, operational, and administrative controls in effect for the University Center project were sufficient to meet the objectives stated in the “Purpose” section of this report.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls changes over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to, resource constraints, faulty judgments, unintentional errors, circumvention by collusion, and management overrides. Establishing controls that would prevent all these limitations would not be cost-effective; moreover, an audit may not always detect these limitations.

The following summary provides management with an overview of conditions requiring attention. Areas of review not mentioned in this section were found to be satisfactory. Numbers in brackets [ ] refer to page numbers in the report.

CHANGE ORDER ADMINISTRATION [6]

Inflated labor rates on change orders from one subcontractor resulted in an overcharge to the campus of $3,529.
INTRODUCTION

BACKGROUND

In May 2008, the Board of Trustees (BOT) approved schematic plans for the University Center project at a cost of $62,000,000, with funding from the issuance of bonds through the systemwide revenue bond program, which will be repaid through funding from campus Housing Services and three auxiliary organizations.

In March 2008, the campus executed an agreement with the architectural firm of Hornberger and Worstell, Inc., for services related and incidental to the design and construction of the University Center project. It also executed an agreement with the construction manager (CM), Sundt Construction, Inc., for pre-construction services that included design and bid phase services. In November 2011, the campus executed a guaranteed maximum price (GMP) agreement with the CM for construction phase services, at a construction cost of $49,190,997, and issued a Notice to Proceed on November 30, 2011, with a completion date of August 13, 2013. The State Fire Marshal granted a Certificate of Occupancy on November 6, 2013, and the campus filed a Notice of Completion on March 27, 2014.

The University Center project is a new, 130,000-square-foot facility, with the first floor designed for retail, food services, events, and conference space. The second and partial third floors are designed for events and conference space and Associated Students, Inc., and student union offices. The building has a structural steel brace frame and a durable precast concrete panel skin. The thin shell precast panel system provides a wide variety of panel sizes, colors, and textures. The design makes internal activities highly visible with the combination of transparent wall systems and skylights providing controlled, natural light. This project also included the creation of a new campus walk along the west side that links the majority of residential housing villages and amplifies commercial activity and outdoor seating space to enhance the pedestrian flow to the Recreation Center Plaza. The project achieved a Leadership in Energy and Environmental Design (LEED) silver rating. LEED is a third-party certification program begun in 1999 by the United States Green Building Council and is a nationally accepted benchmark for the sustainable “green” design, construction, and operation of buildings.

The Sonoma State University campus managed the University Center project, and it chose the Construction Manager at Risk (CM at Risk) with Guaranteed Maximum Price (GMP) delivery method. In this method, a construction management firm chosen by a competitive bidding process provides all or significant portions of design and construction administrative services and takes part in establishing the GMP. The CM at Risk acts as the general contractor during construction, assumes the risk of subcontracting the work, and guarantees completion of the project. The liability for the success in completing the project on time and in budget lies with the construction manager, and not with the university. Further, there is a potential for cost savings should the project be completed below the GMP.

Executive Order (EO) 672, Delegation of Capital Outlay Management Authority and Responsibility, dated July 25, 1997, delegates to campus presidents the authority to manage directly state and non-state funded capital outlay projects. The chancellor’s office issues this delegated authority to the campus subject to its compliance with the capital outlay certification procedure. To comply, the campus submits a request for Delegation of Capital Outlay Management Authority to the Certification Review Board (CRB) for review. Then the executive vice chancellor and chief financial officer in the chancellor’s
office must approve the request. The campus president is responsible for ensuring that he or she exercises delegated authority in compliance with applicable statutes, regulations, and policies of the BOT; the campus manages capital projects via a process consistent with the provisions of the Integrated California State University Administrative Manual (ICSUAM); and the campus has in place appropriate internal controls and processes to ensure that responsibilities are carried out in a manner consistent with the campus capital outlay management plan submitted with the request for delegated authority.

The certification procedure required by EO 672 includes submission of a capital outlay management plan, which defines the campus organizational and operational structure and expenditure authority, and serves as the campus policies and procedures for the administration of construction activities. Updated plans are to be submitted when campus operational structure changes are made that impact the plan. Certification is continuous unless a Capital Planning, Design and Construction (CPDC) post-project performance review determines that problems were caused by campus negligence, in which case the CRB may recommend that the campus be placed on probation. The CRB may ultimately recommend that certification be withdrawn if identified operational/management deficiencies are not remedied.

For those campuses that are not certified, the chancellor’s office may execute a Memorandum of Delegation for a capital outlay project, which delegates administration, including construction management, to the campus. The CPDC construction management unit may also perform construction administration and management.

EO 666, *Delegation of Professional Appointments Related to Capital Outlay Projects and Campus Physical Development*, dated March 7, 1997, delegates the authority to each campus president or designee to make all professional appointments relative to capital outlay projects and campus physical development. Further, the campus president or designee is responsible for ensuring compliance with all applicable statutes and regulations, BOT policies, and ICSUAM guidelines; and the use of systemwide standardized architectural, engineering, and other professional appointment contract forms.

The ICSUAM, in part, contains an overview of all CPDC policies and procedures associated with the capital outlay process. ICSUAM §9700 through §9843, *Construction Management for Public Works Contracts*, describe the requirements for preparing and administering public works contracts under the provisions of Public Contract Code §10700 et seq. ICSUAM §9200 through §9212, *Professional Services for Campus Development*, describe the requirements for developing and administering professional services agreements with service providers such as architects and engineers and for testing services and project-related studies.

The California State University (CSU) *Construction Management Procedures Manual* contains the CSU construction management policies and procedures that apply to a project, and each construction administrator, project manager, inspector of record, campus representative, and design professional is required to use this manual as appropriate during the construction administration of a project.
The overall audit objective was to ascertain the effectiveness of construction management policies and procedures and internal controls and processes related to the administration of construction activities and, specifically, the University Center project.

Within the overall audit objective, specific goals included determining whether:

- Delegated authority to manage capital outlay projects exists, and the campus capital outlay management plan is current for campus-managed projects.
- Project development is in accordance with statutory and CSU policy requirements, including required BOT and CPDC approvals.
- Administration and management of the project provide effective internal controls and processes consistent with the campus capital outlay management plan and the ICSUAM.
- Professional appointments are in accordance with statutory requirements, BOT policy, and the ICSUAM; and systemwide standardized professional appointment contract forms are used, approved by the Office of General Counsel, and fully executed prior to performance of work.
- Extra services are appropriate, authorized, and separately tracked; and an evaluation is performed for each professional service provided.
- The bidding process is rigidly controlled, performed in accordance with statutory requirements and the ICSUAM, and incorporates the contract documents maintained on the CPDC website.
- Contract documents are complete, routed to the Office of General Counsel as appropriate, and timely executed; required contract bonds and insurance are received; and a Notice to Proceed is issued.
- Subcontractors are adequately monitored, and requests for subcontractor substitutions are handled in accordance with statutory requirements and the ICSUAM.
- Operational and administrative controls ensure maintenance of financial accountability and completion of the project within the approved scope, schedule, and budget.
- Contract and service agreement payments are adequately supported, appropriately approved, and timely paid; and retention is handled in accordance with statutory requirements and the ICSUAM.
- Group II equipment is properly managed and accounted for, purchased materials meet specifications required by construction documents and drawings, and all required inspections and tests are timely and properly performed and adequately documented.
Change orders are appropriately approved, supported, accurately priced, and sufficiently tracked; and construction allowances and contingency balances are adequately administered and controlled.

Project completion is adequately administered, including completion of pre-final/final inspections, punch list items, project closeout checklist, and Notice of Completion; preservation of project files, equipment manuals/warranties, and spare parts/materials; and resolution of any liquidated damages.

**SCOPE AND METHODOLOGY**

The scope of audit included, but was not limited to, the review of design budgets and costs; the bid and award process; invoice processing and payment; change orders; construction management, architectural, and engineering services; use of major equipment/materials; the closeout process; administration of liquidated damages; and overall project cost accounting and reporting. This included any transactions or activity performed by the campus, construction management firm, and trade subcontractors.

Our study and evaluation were conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors, and included the audit tests we considered necessary in determining whether fiscal, operational, and administrative controls are in place and operative. This review emphasized, but was not limited to, compliance with state and federal laws, BOT policies, and Office of the Chancellor and campus policies, letters, and directives.

We focused primarily on the operational and administrative controls in effect for the University Center project with an emphasis on compliance with the CSU *Construction Management Procedures Manual*, ICSUAM policies and procedures associated with the capital outlay process, the campus capital outlay management plan, and construction contract general conditions. We evaluated the effectiveness of construction management policies and procedures and adequacy of internal controls and processes, and sought opportunities for improvement to further the success of CSU’s capital outlay program.

Specifically, we reviewed and tested:

- Delegation of construction management authority.
- Review and approval of project design, budget, and funding.
- Professional services agreements and any extra services changes.
- Administration of the bid and award process.
- Contract execution and required contract bonds and insurance.
- Subcontractors and subcontractor substitutions.
- Contract and service agreement payment processing.
- Procurement of major equipment and materials.
- Performance of required inspections and tests.
- Review, approval, and tracking of change orders.
- Direct labor and associated burden.
- Construction management and overall project cost accounting and reporting.
- Construction allowances and contingency balances.
- Administration of the project closeout process and resolution of any liquidated damages.
OBSERVATIONS, RECOMMENDATIONS, AND CAMPUS RESPONSES

CHANGE ORDER ADMINISTRATION

Administration of trade subcontractor labor rates and associated labor burden needed improvement.

We reviewed hourly labor rates and the associated labor burden charged by two trade subcontractors for a sample of change orders, and we found that one trade subcontractor charged inflated labor rates on five separate change order requests. This increased labor costs by $3,529.

The Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects §6.01.b (1) states that the construction manager (CM) and trade contractors shall submit a fully detailed breakdown of the cost of every labor classification to be utilized on a proposed change on the hourly labor rate worksheet. The unit cost of labor shall be an accurate accounting of actual costs being paid.

The associate vice president for administration and finance stated that the inflated labor rates were not identified due to oversight.

Insufficient review of hourly labor rates and the associated labor burden charged to the project may result in increased project costs.

Recommendation 1

We recommend that the campus:

a. Pursue recovery of the $3,529 in inflated labor costs charged by the trade subcontractor and determine, as appropriate, if other change order work performed by this trade subcontractor was cost-inflated in a similar manner. The results of this recovery should be reported to the chancellor’s office Capital Planning, Design and Construction department.

b. Conduct staff training to ensure that hourly labor rates and the associated burden charged by trade subcontractors are properly reviewed and accurate in accordance with §6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects.

Campus Response

We concur.

a. We will contact Sundt Construction, Inc. to request a refund of $3,529 due to the erroneous hourly labor rate charged by the trade subcontractor, North Counties Drywall, Inc. We will report the results to the chancellor’s office Capital Planning, Design and Construction department.
b. The associate vice president for administration and finance, facilities operations and planning will conduct a formal training seminar with the capital planning, design and construction project managers to ensure that hourly labor rates charged by trade subcontractors are appropriate and accurate in accordance with §6.00, Changes in the Work, of the *Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects*.

Expected completion date: April 15, 2015
### APPENDIX A:
### PERSONNEL CONTACTED

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
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<tbody>
<tr>
<td><strong>Office of the Chancellor</strong></td>
<td></td>
</tr>
<tr>
<td>Elvyra San Juan</td>
<td>Assistant Vice Chancellor, Capital Planning, Design and Construction</td>
</tr>
<tr>
<td><strong>Sonoma State University</strong></td>
<td></td>
</tr>
<tr>
<td>Ruben Armiñana</td>
<td>President</td>
</tr>
<tr>
<td>Christopher Dinno</td>
<td>Associate Vice President, Administration and Finance</td>
</tr>
<tr>
<td>Laurence Furukawa-Schlereth</td>
<td>Vice President, Administration and Finance</td>
</tr>
<tr>
<td>Nathan Johnson</td>
<td>Police Chief and Executive Director for Risk Management, Internal Control and Information Security</td>
</tr>
<tr>
<td>Kurt Koehle</td>
<td>Director, Internal Operations</td>
</tr>
<tr>
<td>Ming-Lan (Joy) Sun</td>
<td>Manager of Contracts and Procurement</td>
</tr>
</tbody>
</table>
March 3, 2015

MEMORANDUM

TO: Larry Mandel
   Vice Chancellor and Chief University Auditor
   California State University
   401 Golden Shore, 4th Floor
   Long Beach, California 90802-4200

FROM: Laurence Furukawa-Kohlereth
      Chief Financial Officer and
      Vice President for Administration and Finance

SUBJECT: Incomplete Draft Audit Report (14-12) for the University Center Construction Project – Campus Response

On behalf of President Armiñana, I am submitting the Campus Response to the recommendations of the Preliminary Draft Audit Report #14-12, University Center construction project. Upon acceptance of this response, we will provide documentation to demonstrate the completion of corrective actions for the recommendations.

This memorandum [pdf copy], and the Campus Response will be sent via email to OAAS@calstate.edu.

Attachment

   c: Ruben Armiñana, President
      Nathan Johnson, Chief of Police and Executive Director for Enterprise Risk Management
      Christopher Dinno, AVP for Administration and Finance, Facilities Operations and Planning
      David Crozier, Senior Director, University Financial Services
      Kurt Koehle, Police and Safety Services
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CHANGE ORDER ADMINISTRATION

Recommendation 1

We recommend that the campus:

a. Pursue recovery of the $3,529 in inflated labor costs charged by the trade subcontractor and determine, as appropriate, if other change order work performed by this trade subcontractor was cost-inflated in a similar manner. The results of this recovery should be reported to the chancellor’s office Capital Planning, Design and Construction department.

b. Conduct staff training to ensure that hourly labor rates and the associated burden charged by trade subcontractors are properly reviewed and accurate in accordance with §6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects.

Campus Response

a. We agree. We will contact Sundt Construction, Inc. to request a refund of $3,529 due to the erroneous hourly labor rate charged by the trade subcontractor, North Counties Drywall, Inc. We will report the results to the chancellor’s office Capital Planning, Design and Construction department.

b. We concur. The Associate Vice President for Administration and Finance, Facilities Operations and Planning will conduct a formal training seminar with the capital planning, design and construction project managers to ensure that hourly labor rates charged by trade subcontractors are appropriate and accurate in accordance with §6.00, Changes in the Work, of the Contract General Conditions for CM at Risk with Guaranteed Maximum Price Projects.

Expected completion date: April 15, 2015
March 18, 2015

MEMORANDUM

TO: Mr. Larry Mandel
    Vice Chancellor and Chief Audit Officer

FROM: Timothy P. White
      Chancellor

SUBJECT: Draft Final Report 14-12 on the
         University Center, Sonoma State University

In response to your memorandum of March 18, 2015, I accept the response
as submitted with the draft final report on the University Center, Sonoma State
University.

TPW/amd